As Debt Climbs to New Record Levels, Where Should Investors Turn?

Description

Canadian household debt has reached record levels again. Bank of Canada governor Stephen Poloz recently spoke at a press conference in Toronto and indicated that the economy will need less stimulus going forward. It seems we are left with two conflicting data points.

But at the end of the day, with the U.S. recently raising rates, and the Canadian economy performing well, the reality is that longer term, raising rates is good for the economy.

So, it looks like rates may be rising faster than the market and consumers are hoping.

Debt

In what has now become a familiar theme, Statistics Canada has released household debt numbers that show debt levels at new highs.

Now at 171.1% of disposable income, debt levels continue to rise, and as borrowing continues to rise faster than disposable income, we need to be cognizant of the risks.

Financials

Rising rates will have the effect of reducing consumers' disposable income, as more of their money goes to interest payments to, you guessed it, financial institutions.

Against this backdrop, investors should increase their holdings in financial stocks, who stand to benefit from rising rates.

In the third quarter, we saw a big improvement in **National Bank of Canada's** (TSX:NA) results. Earnings per share came in at $1.39 compared to $0.78 in the same quarter last year for an increase of 78%, as strong revenue growth across all segments combined with reduced operating costs positively impacted results.

These results compare favourably to both **Canadian Imperial Bank of Commerce** (TSX:CM)(
NYSE:CM

) and **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), which reported increases in EPS of 25% and 18%, respectively.

Rising interest rates have helped the results of all banks this year, and looking to 2018, they should continue to do so. And with the risk that rates rise further, this positive effect will be accentuated.

Consumer spending

Further to this, investors should limit their exposure to consumer discretionary companies, or companies that satisfy consumer “wants” as opposed to their “needs.”

That includes retailers, such as **Canada Goose Holdings Inc**. (TSX:GOOS)(NYSE:GOOS), which has had a phenomenal run since its IPO earlier, more than doubling in value. **Aritzia Inc.** (TSX:ATZ) is 20% lower than its IPO price. **Roots Corp**. (TSX:ROOT) is 12% lower than its IPO price.

I think these retailers will be facing a tougher environment, as consumer spending will be weaker, in my view, as Canadians will have less money in their pockets.

In closing, I would like to reiterate that if we are heading into a new environment going forward, we need to assess our portfolios, because what worked in the last few years will not work in the years to come.

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